

Application No: A.11-11-002
Exhibit No.: _____
Witness: Gary Lenart

)
In the Matter of the Application of San Diego Gas &)
Electric Company (U 902 G) and Southern California)
Gas Company (U 904 G) for Authority to Revise)
Their Rates Effective January 1, 2013, in Their)
Triennial Cost Allocation Proceeding.)
_____)

A.11-11-002
(Filed November 1, 2011)

REBUTTAL TESTIMONY OF

GARY LENART

SAN DIEGO GAS & ELECTRIC COMPANY

AND

SOUTHERN CALIFORNIA GAS COMPANY

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

December 14, 2012

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1 **REBUTTAL TESTIMONY OF**

2 **GARY LENART**

3 My name is Gary Lenart. My business address is 555 West Fifth Street, Los Angeles,
4 California, 90013-1011. I have previously submitted testimony in this proceeding.

5 The purpose of my rebuttal testimony is to address comments regarding (1) Pipeline
6 Safety Enhancement Plan (PSEP) cost allocation; (2) marginal unit costs for the customer cost
7 function; and (3) transition adjustments. Specifically, I will be addressing comments by Division
8 of Ratepayer Advocates (DRA) witnesses Ms. Sabino and Mr. Renaghan, The Utility Reform
9 Network (TURN) witness Mr. Marcus, Southern California Edison (SCE) witness Mr. Garwacki,
10 City of Long Beach witness Mr. Fulmer, Southern California Generation Coalition (SCGC)
11 witness Ms. Yap, and Southern California Indicated Producers and Watson Cogeneration
12 Company (IP/Watson) witness Mr. Beach.

13 **I. PSEP COST ALLOCATION¹**

14 Three parties (Edison, IP/Watson, and City of Long Beach) supported the adoption of
15 SoCalGas and SDG&E's PSEP cost allocation proposal in full, SCGC supported adoption in
16 part, while two parties (DRA and TURN) opposed. The issues for decision include Equal
17 Percent of Allocated Margin (EPAM) versus Functionalized (Default) cost allocation, the line-
18 item surcharge, allocating PSEP costs to the Backbone Transmission Service (BTS) rate, the
19 fixed monthly surcharge for residential class, and the 20% discount for California Alternative
20 Rate for Energy (CARE) customers.

¹ Parties presented various positions regarding the plan in Phase 1, but regardless of the outcome of that proceeding, the resulting revenue requirements will be allocated as decided by the Commission in Phase 2.

1 **A. EPAM is the appropriate cost allocation for PSEP**

2 **1) The cost causation is the enhanced safety of all people in the service area**

3 On Page 4 of Mr. Lenart’s Updated Prepared Direct TCAP testimony, the following three
4 principles for cost allocation were laid out; (1) Costs are to be allocated to customer classes
5 based on cost causality; (2) Avoid rate shock and keep a customer perspective; and (3) Maintain
6 consistency with current practice whenever possible. The task here is to determine cost
7 causality.

8 Witnesses Beach, Yap, Garwacki, and Fulmer support the EPAM method in their
9 testimonies. Also, Ms. Yap concludes that while “(s)afety measures ensure the safety of
10 populace, which in ratemaking terms amounts to customers,”² allocating PSEP almost
11 exclusively to the residential customers would “fail to recognize the reliability benefits that other
12 classes will receive from the PSEP program.”³ Therefore, she continues, “(a)n EPAM allocation
13 assures that cost responsibility is assigned to the customer classes based on a combination of
14 factors.”⁴

15 Mr. Garwacki of Edison compared the PSEP cost allocation issue to the electric utility
16 allocation of uneconomic Competition Transition Cost charges, which are allocated “based on
17 the SAPC (or EPAM) method.”⁵ Mr. Fulmer notes that “(a)llocating PSEP costs on an EPAM
18 basis will more appropriately match costs and safety benefits to different customer classes.”⁶

19 On the other hand, while Ms. Sabino correctly notes that “(c)ost responsibility should
20 match cost causation,”⁷ she incorrectly concludes that “the default cost allocation, not the

² Phase 2 Direct Testimony of Catherine E. Yap on behalf of Southern California Generation Coalition, p. 3.

³ Ibid., p. 3.

⁴ Ibid., p. 4.

⁵ Southern California Edison Company, Direct Testimony on Phase II Issues, p. 4.

⁶ Testimony of Mr. Fulmer on behalf of the City of Long Beach, p. 20.

⁷ DRA Report on the Application of Southern California Gas Company and San Diego Gas & Electric Company in the 2013 Triennial Cost Allocation Proceeding Phase II, DRA-07, pages 1-19.

1 proposed EPAM allocator, is the more appropriate methodology to use...because it would match
2 cost responsibility with cost causation.”⁸ In order to make that conclusion, Ms. Sabino asserts
3 that “the plan itself is transmission-related”⁹ and “(t)he proposed EPAM is not representative of
4 the cost drivers for transmission and high pressure distribution.”¹⁰ However, despite the fact that
5 the proposed work is on the transmission and high pressure distribution systems, the work is not
6 being done to enhance the functional performance of those systems. The functional allocation
7 proposed by Ms. Sabino, which would allocate PSEP costs by end-use customers’ demand on the
8 system, would be appropriate with costs caused with the intention of increasing the capacity or
9 reliability of the system. Here, however, the essential functional performance of the pipelines
10 will remain the same before and after the PSEP work is done. The cost causation is to enhance
11 the safety of all people in the SoCalGas and SDG&E gas service territories. SoCalGas and
12 SDG&E assert that the EPAM method better matches cost responsibility with cost causation than
13 a functionalized approach, and that the cost allocation proposal of Ms. Sabino should be rejected.

14 **2) PSEP Is not the same as Transition Integrity Management Plan (TIMP)**

15 In TURN’S argument against EPAM, Mr. Marcus claims “TIMP costs are functionalized,
16 not allocated on an equal percent of margin basis.”¹¹ TIMP is the nationwide standard for
17 pipelines set by Pipeline and Hazardous Materials Safety Administration (PHMSA) and as such
18 it is proper to functionalize. However, PSEP is an enhanced safety plan, to be implemented
19 Statewide and not Nationwide. It goes well beyond TIMP, and therefore the two cannot be
20 compared. Therefore, this reason does not make it inappropriate to allocate PSEP EPAM.

⁸ Ibid., p. 1-20.

⁹ Ibid., p. 1-19.

¹⁰ Ibid., p. 1-16.

¹¹ Prepared Testimony of Mr. Marcus on behalf of The Utility Reform Network, p. 15.

1 **3) All customers benefit equally**

2 SoCalGas and SDG&E reject TURN’s characterization of the EPAM method as “an
3 attempt to shift the costs away from” certain customer classes.¹² Additionally, SoCalGas and
4 SDG&E reject Ms. Sabino’s claim that we “have not made any showing or demonstrated in this
5 Application that the residential customer class is the primary beneficiary of the” PSEP.¹³

6 It is not being claimed that the residential class is the primary beneficiary of PSEP.
7 Rather, all customers benefit equally from the PSEP. As such, the EPAM method, which
8 impacts customers equally, appropriately matches cost responsibility with cost causation and
9 should be approved.

10 Ms. Sabino’s final point on PSEP cost allocation is that SoCalGas and SDG&E’s
11 “concern over ‘relative equity’ should not be made the deciding factor for the cost allocation of
12 the PSEP particularly because the Applicants narrowly view ‘relative equity’ only in terms of
13 the” PSEP.¹⁴ She argues that when the General Rate Case (GRC) and TCAP proposals are taken
14 into consideration, the picture of equity can be viewed differently. However, the GRC and
15 TCAP are regular proceedings that determine the cost of running the two businesses and how
16 those costs should be allocated among ratepayers. Neither of those two proceedings has any
17 bearing on PSEP costs. The allocation of incremental PSEP revenue requirement should rightly
18 be scrutinized, but it should be done so in isolation and on the merits of its own cost
19 causation/cost responsibility analysis.

20 **B. PSEP costs should be recovered through a line-item surcharge**

21 TURN is the only party challenging the proposal to collect PSEP revenue requirements in
22 a line-item surcharge. Mr. Marcus’ contention is that “the utilities have not provided sufficient

¹² Ibid., p. 15.

¹³ DRA Report, DRA-07, p. 1-24.

¹⁴ DRA Report, DRA-07, p. 1-24.

1 support for treating these costs differently than all of the similar costs of providing service.”¹⁵
2 SoCalGas and SDG&E do not believe that the PSEP is similar to other costs of providing
3 service. This potentially large revenue requirement is the direct result of Commission action
4 following the tragic San Bruno pipeline explosion. SoCalGas and SDG&E believe that safety of
5 utility pipelines is of concern to many residents in our service territory. However, many other
6 residents are concerned about any increases in their utility bills. The line-item surcharge
7 provides transparency to both those customer groups. SCIP/Watson witness Mr. Beach agrees
8 that “a separate PSEP surcharge makes sense as a result of the extraordinary nature of these
9 safety-related costs, (and) the public attention to these issues...,”¹⁶ while DRA “does not oppose
10 the Applicants’ proposal to show the PSEP Surcharge as a separate line item on the customer
11 bill.”¹⁷ Consequently, SoCalGas and SDG&E’s proposal to recover PSEP costs through a line-
12 item surcharge should be accepted. However, should the Commission decide that a line-item
13 surcharge is not appropriate for recovery of PSEP costs and that PSEP should be recovered in
14 base transportation rates, the EPAM allocation factor is still the appropriate method of allocating
15 costs to the customer classes.

16 **C. The BTS rate should not be allocated PSEP costs**

17 SCGC is the only party to propose allocating PSEP costs to the BTS rate. While
18 supporting the EPAM cost allocation in general, Ms. Yap claims an omission was made in
19 excluding the BTS rate from the allocation.¹⁸ SoCalGas and SDG&E disagree. Absent a

¹⁵ Direct Testimony of Mr. Marcus, p. 17.

¹⁶ Prepared Direct Testimony of Mr. Beach on behalf of The Southern California Indicated Producers and Watson Cogeneration Company, p. 19.

¹⁷ DRA Report, DRA-07, p. 1-27.

¹⁸ Direct Testimony of Ms. Yap, p. 4.

1 significant Off System Delivery market,¹⁹ all BTS users are eventually end-users, so all of
2 SoCalGas and SDG&E's customers will eventually pay for the PSEP.

3 SoCalGas and SDG&E instead agree with Ms. Yap's statement that "the EPAM allocator
4 is a good one if the Commission determines that PSEP revenue requirement should be allocated
5 as a single un-functionalized amount each year."²⁰ The cost causality principle guides this
6 position. As previously discussed, enhanced safety equally benefits everyone. Enhanced safety
7 can be considered in this case to be the "function" to which costs are being allocated, because it
8 is in the name of enhanced safety that these costs are being incurred. Since enhanced safety is
9 not a traditional function, SoCalGas and SDG&E proposed to use the EPAM allocator, which
10 allocates costs in an equitable way across the customer classes. Taking cost causality further, the
11 BTS rate does not represent a customer class, but is instead a rate that all customer classes pay in
12 one form or another (e.g., embedded in core procurement or city-gate market price) in order to
13 access the backbone transmission system. The enhanced safety measures do not increase the
14 value of the backbone transmission system to customers in terms of added capacity, and
15 therefore from a position of cost causality PSEP should not be allocated to the BTS rate.

16 **D. The residential surcharge should be a fixed monthly charge**

17 Since the new PSEP function is not being caused by throughput on the system and the
18 PSEP costs will not vary with volumes delivered; a fixed customer charge follows the cost-
19 causation principle.

¹⁹ There are currently no Off System Delivery Customers.

²⁰ Direct Testimony of Ms. Yap, p. 3.

1 **E. The 20% discount for CARE on the fixed monthly charge is appropriate**

2 Assuming SoCalGas and SDG&E’s proposal for a fixed monthly surcharge is adopted,
3 TURN proposes a larger surcharge discount for CARE customers than the state-mandated 20%.²¹
4 Mr. Marcus’ claim is that CARE customers use about 20% less gas than non-CARE customers,
5 so the discount is rendered meaningless. SoCalGas and SDG&E disagree. In matching cost
6 responsibility with cost causation, SoCalGas and SDG&E acknowledge that all customers
7 benefit equally from PSEP regardless of demand on the system. This is principally why a per-
8 customer monthly surcharge was proposed for the residential class. Since the residential
9 surcharge was designed without consideration of relative levels of throughput, then adjusting the
10 CARE discount simply because as a group they use less on average would be inappropriate.
11 TURN’s proposal regarding the CARE discount should be rejected.

12 **II. SUMMARY OF PROPOSED PSEP RATES**

13 The PSEP rates proposed by SoCalGas and SDG&E and interveners that provided them
14 are shown below in Table 1. Column A lists the transportation rates in order to compare the
15 impact of PSEP costs. Column B is SoCalGas and SDG&E’s proposed PSEP rates. Notice the
16 range impacting all rate classes equally at around 15%. Column D²² is SCGC’s proposal which
17 has the EPAM allocation with an allocation to the BTS; however, there is still an equal rate
18 impact of around 15%.

19 Column F is DRA’s proposal using the functionalized allocation.²³ Notice that the
20 impacts are not equal among the rate classes. There is a much broader range, topping out at
21 93%.

²¹ Prepared Testimony of Mr. Marcus, p. 16.

²² Derived from Direct Testimony of Ms. Yap, Table 3, p. 10.

²³ Derived from DRA Report, DRA-07, Table 1-5, p. 1-28.

Table 1
Comparison of Impact on PSEP Rates
Resulting From the Allocation Proposals

	2013 TCAP SoCalGas Proposed Rates A	SoCalGas / SDG&E Proposed PSEP Rates		SCGC Proposed PSEP Rates		DRA Proposed PSEP Rates		
		EPAM B	% Increase C = B/A	EPAM w/ allocation to BTS D	% Increase E = D/A	Functional Allocation F	% Increase G = F/A	
1	<u>SoCalGas Rates \$/th, except as noted</u>							
2								
3	Residential	\$0.560	N/A	N/A	\$0.072	13%	\$0.050	9%
4	Avg Monthly Res Bill - \$/mo	\$39.18	\$2.91	7%	\$2.75	7%	\$1.96	5%
5	Avg Monthly Res Bill w/out G-CP - \$/mo	\$22.76	\$2.91	13%	\$2.75	12%	\$1.96	9%
6	Core Commercial & Industrial	\$0.235	\$0.033	14%	\$0.031	13%	\$0.036	15%
7	Gas Air Conditioning	\$0.068	\$0.010	15%	\$0.010	14%	\$0.019	28%
8	Gas Engine	\$0.091	\$0.014	15%	\$0.013	14%	\$0.012	13%
9	Natural Gas Vehicles	\$0.064	\$0.010	15%	\$0.009	14%	\$0.027	42%
10								
11	Noncore C&I - Distribution Level Service	\$0.051	\$0.007	13%	\$0.006	12%	\$0.024	46%
12	Electric Generation - Distribution Level							
13	Service	\$0.032	\$0.004	11%	\$0.005	15%	\$0.026	79%
14	EOR - Distribution Level Service	\$0.032	\$0.004	11%	\$0.005	15%	\$0.026	79%
15	Transmission Level Service	\$0.013	\$0.001	9%	\$0.001	9%	\$0.012	93%
16	Backbone Transmission Service \$/dth/day	\$0.162	\$0.000	0%	\$0.018	11%	\$0.000	0%
17	<u>SDG&E Gas Rates \$/th, except as noted</u>							
18								
19	Residential	\$0.670	N/A	N/A		0%	\$0.081	12%
20	Avg Monthly Res Bill - \$/mo	\$36.99	\$2.91	8%		0%	\$2.74	7%
21	Avg Monthly Res Bill w/out G-CP - \$/mo	\$22.73	\$2.91	13%		0%	\$2.74	12%
22	Core Commercial & Industrial	\$0.193	\$0.033	17%		0%	\$0.047	24%
23	Natural Gas Vehicles	\$0.073	\$0.010	14%		0%	\$0.027	37%
24								
25	Noncore C&I - Distribution Level Service	\$0.173	\$0.007	4%		0%	\$0.029	17%
26	Electric Generation - Distribution Level							
27	Service	\$0.031	\$0.004	12%		0%	\$0.026	84%
28	Transmission Level Service	\$0.013	\$0.001	9%		0%	\$0.012	93%

1 **III. MARGINAL UNIT COSTS FOR THE CUSTOMER-COST FUNCTION**

2 There are two areas regarding the updated marginal cost study that was done for the
3 Customer-Related Function that have differing proposals among the interveners. These areas
4 are:

5 A. The LRMC method that was used; and,

6 B. The marginal cost of wholesale meters.

7 **A. The Rental method appropriately determines marginal unit costs**

8 DRA, TURN, and City of Long Beach oppose SoCalGas and SDG&E’s proposal to use
9 the rental method for determining marginal unit costs. DRA and Long Beach propose use of the
10 New Customer Only (NCO) method, while TURN proposes the NCO method adjusted to include
11 Replacement Cost Adders.²⁴

12 NCO is a highly theoretical approach relying on costs incurred by new customers, while
13 the Rental method recognizes the reality that most of the customer-related costs are being caused
14 by the existing customer base. When comparing the two approaches it is a debate pitting “NCO
15 Theory” against “Rental Reality.” The NCO method is flawed and should be rejected by the
16 Commission.

17 The ultimate goal of cost allocation is to allocate the authorized revenue requirement to
18 the rate classes based on cost causation. New customers did not cause the on-going customer-
19 related costs that are being incurred by our existing customer base.²⁵ Therefore we should be
20 allocating customer-related costs in a fashion that does not ignore this, but instead recognizes
21 that customer-related costs are being caused by the existing customer base.

²⁴ Replacement Cost Adders will be addressed in Supplemental Rebuttal Testimony to be submitted on December 21, 2012 due to TURN’s late-filed Supplemental Direct Testimony addressing this issue.

²⁵ The main cause of total customer-related costs that are incurred is the large size of our existing customer base. Cost items such as return, depreciation, taxes, O&M, call center operations, appliance service representatives, are all items that are overwhelmingly incurred to support the existing customer base of over 5 million customers.

1 The Rental method relies on the marginal unit cost of one more customer and then
 2 applies this to the total existing customer base. Conversely, the NCO method only relies on the
 3 costs incurred by new customers. When you consider that the existing customer base is
 4 composed of over 5 million customers and the number of new customers amounts to
 5 approximately 25,000, it is not difficult to recognize that the majority of costs are being caused
 6 by the 5 million and not the 25,000. As a point of comparison, the NCO method is basing its
 7 allocation on \$39 million²⁶ of costs for new customers while the net book value of existing
 8 meters at SoCalGas is over \$400 million, and that doesn't even include the service lines.

9 The following table illustrates the difference in the customer-related costs for SoCalGas
 10 under the Rental method and the NCO method. As illustrated for SoCalGas, the NCO method
 11 assigns a much lower cost for the customer-related function.

12 **Table 2**
 13 **Comparison of Residential Customer-Related Costs**
 14 **Rental and NCO methods**
 15 **Southern California Gas Company**

Residential Allocation	Rental	NCO	Difference
UnScaled Customer- Related Costs (\$000)	\$1,199,620	\$577,671	(\$621,949)

16 **1) The New Customer Only method ignores existing customer base**

17 As previously discussed, the NCO method depends on a relatively small new customer
 18 count of approximately 25,000 while ignoring an existing customer base of over 5 million in
 19 determining the marginal unit cost. The result of this methodology is obvious from Table 2,
 20 which shows an over \$600 million difference in customer-related costs allocated to the
 21 Residential Class. This difference, an amount that to a large degree is caused by the existing
 22 residential customer base, must then be paid for by other rate classes.

²⁶ See Table 3, row 5.

1 The Rental method simply takes the marginal unit capital expenditure amortized over the
2 authorized rate of return to arrive at a Marginal Unit Cost/year, which is then applied to the
3 forecasted number of customers (approximately 5 million). The NCO method uses the same
4 marginal unit capital expenditure and determines the “purchase cost” as the present value per
5 unit of the amortized payments over book life of over 30 years. This is then applied to the
6 number of new customers. Since a marginal unit cost is required to complete the allocation of
7 customer-related costs to the total customer base of over 5 million customers, the NCO method
8 then divides this by the actual number of customers to arrive at the Marginal Unit Cost which
9 can be applied to the forecasted number of customers (again, approximately 5 million).

10 As can be seen for SoCalGas in Table 3, the NCO method results in drastically lower
11 customer costs. This happens by virtually ignoring the existing base of over 5 million customers.
12 Because customer class growth is the main driver in the NCO method, this method (except where
13 the growth rate of a customer class is very high) will significantly understate true marginal
14 customer-related costs, thereby artificially lowering core rates. This is why the NCO method,
15 which applies the margin cost only to new customers, is economically inefficient, suboptimal,
16 and results in an understatement of LRMC-based customer costs. The understatement occurs
17 because the NCO cost reflects the total capital cost for less than 1% of the total Residential
18 customers. As a result, a significant portion of the customer-related costs end up as part of
19 scaling.

20 Therefore, SoCalGas and SDG&E’s marginal customer-related capital costs have been
21 developed using the Rental method, which reflects the annualized capital cost of new hookups.

22

1
2
3
4
5
6

Table 3
Comparison of Rental & NCO Calculations of the
Marginal Unit Customer Cost
And
Total Customer-Related Costs
For the Residential Rate Class at SoCalGas

Rental Method			NCO Method				
1		Marginal Investment/ customer	\$1,308.85	1	Marginal Investment/ customer	\$1,308.85	
2	*	RECC	9.10%	2	* PVRR	1.242	
3		<i>n/a</i>		3	= Present Value/ customer	\$1,625.40	
4		<i>n/a</i>		4	* Number of New Customers	24,152	
5		<i>n/a</i>		5	= Amount incurred by new customers \$000	\$39,257	
6		<i>n/a</i>		6	/ Total Number of Customers	5,327,003	
7	=	Capital related Portion of Marginal Unit Cost \$/customer	\$119.46	7	= Capital related Portion of Marginal Unit Cost \$/customer	\$7.37	
8	+	O&M Loaders	\$96.74	8	+	O&M Loaders	\$96.74
9	=	Marginal Unit Cost/ customer	\$216.19	9	= Marginal Unit Cost/ customer	\$104.11	
10	*	Forecasted # Customers	5,548,845	10	* Forecasted # Customers	5,548,845	
11	=	Allocated Customer- Related Costs \$000	\$1,199,620	11	= Allocated Customer- Related Costs \$000	\$577,671	

2) Changes in customer growth skew marginal costs using the NCO method

The NCO method is heavily based on the number of new customers. (see Line #4 under NCO in Table 3). This is where the NCO allocation is swayed by changes in housing demand. This is not a good allocator for the existing customer base of more than 5 million customers. They shouldn't be allocated more or less due to the level of residential construction in the Southern California market, especially considering the amount of new construction is a very small fraction of the existing base ($24,152/5,327,003 = 0.5\%$). The rental method uses the same

1 marginal capital expenditure per customer that the NCO method does (see Line #1 in Table 3);
2 however, the Rental method of allocating customer-related costs is not as dependent on the new-
3 customer sub-segment of our 5 million existing customer base. Further, it should be pointed out
4 that the total customer-related costs incurred by the Utility and included in its base margin
5 revenue requirement, which was authorized in the last GRC, are being caused primarily by the
6 existing customer base and not the new ones. The Rental method determines the marginal unit
7 cost of one more customer, without being biased by number of new customers. In contrast, the
8 NCO method relies heavily on the relatively small number of new customers to determine the
9 marginal unit cost.

10 **3) The marginal unit cost is required for allocation; not the total marginal**
11 **cost spent on new customers**

12 In an LRMC study, the marginal unit cost is the driver for cost allocation, and the NCO
13 method does not appropriately determine marginal unit costs. SoCalGas and SDG&E correctly
14 define the term “marginal” as referring to the cost to provide service for the next customer or, for
15 demand related costs, an additional therm of throughput. In the marginal cost study for the
16 distribution systems, which DRA supports²⁷, the marginal unit cost for all forecast demand is
17 based on the cost to provide one additional unit of demand. Likewise for the customer cost
18 function, all customers should be charged the cost of providing service to an additional customer.
19 This occurs in the Rental method. TURN posits that “distribution capacity...(is) common or
20 fungible” and that “the equipment serving a customer facility has no value apart from the
21 location where it exists.”²⁸ This may be true, but when the building at which the connection
22 equipment is connected is sold or rented, the existence or non-existence of connection equipment

²⁷ DRA Report, DRA-03, pages 1-10 through 1-14.

²⁸ Prepared Testimony of Mr. Marcus, p. 4.

1 adds or subtracts value to the buyer or renter. The equipment itself may not be movable, but
2 other renters or owners that come and go will receive value from the existence of the equipment.

3 In a competitive market, the market price for a product is based on the marginal cost of
4 producing one additional unit of output. That price clears the market where all units produced
5 are sold and the cost of the marginal unit of output equals the consumer value of purchasing that
6 marginal unit of output. The NCO method relies on a convoluted process in order to determine
7 the marginal unit cost. As detailed in the previous section, the “marginal unit cost” under the
8 NCO method is nothing more than the total cost to hook up new customers in each class divided
9 by the total number of customers in the class. This in no way represents a true marginal unit cost
10 for serving one additional customer. The Rental method, utilizing the Real Economic Carrying
11 Charge (RECC), accurately determines that marginal cost to the utility and thus to the ratepayer.

12 **4) There is no difference between owning and renting because an**
13 **opportunity cost is incurred when owning**

14 TURN asserts that the Rental method “is based on an environment where a competitive
15 rental market for customer access equipment exists but where purchase or up-front payment for
16 that equipment is prohibited.”²⁹ The NCO method takes this assertion to the complete other side
17 of the spectrum and assumes all customers will chose to purchase rather than rent because it is
18 the most economical decision to make.

19 The Rental method as used by SoCalGas and SDG&E correctly assumes that all
20 customers, whether owners or renters, face the same real costs because it does not matter
21 whether a customer is a renter or an owner. The cost to each is the same just as the rent charged
22 to a renter of a house is equal to the cost that owners incur by not renting their house out and
23 using it themselves. This is the opportunity cost principle of economics. In other words, if I

²⁹ Prepared Testimony of Mr. Marcus, p. 5.

1 own a house free and clear of any debts and use it for myself, it costs me the rent that I could
2 have charged a renter if I had rented the house out.

3 **5) A precedence for the NCO method has not been made by the Commission**

4 TURN, DRA, and Long Beach contend that the NCO method is the long-standing
5 approach adopted by the California Public Utilities Commission (Commission). However, the
6 methodology used to develop the marginal unit costs for customer-related facilities has taken a
7 long and complicated path to the present. In the original LRMC decision, the Commission
8 adopted the Rental method. In subsequent BCAPs, the Commission has stated a “preference” for
9 the NCO methodology. However, the use of the Rental or NCO method has not been fully
10 litigated over the last four times the Commission has heard this issue due to settlement
11 agreements by parties adopting particular methodologies for each utility. The Utilities entered
12 into these settlement agreements with the understanding that the acceptance of a particular
13 approach was not precedential for future proceedings. The Commission’s position has been to
14 assess the specific circumstances surrounding the marginal cost calculations in each proceeding
15 and then determine which methodology is most appropriate for that specific proceeding. The
16 rental method especially makes the most sense this time because of the historically low number
17 of new customers.

18 The evolution of the methodology to calculate customer-related facilities highlights that
19 the LRMC methodology is contentious. Even while promoting the NCO method, Long Beach
20 witness Mr. Fulmer admits that he is “not convinced...that either the Rental method or the NCO
21 method is clearly superior.”³⁰ SoCalGas and SDG&E believe the Rental method is the correct
22 method because it most closely resembles the actions of our customers.

³⁰ Testimony of Mr. Fulmer, p. 7.

1 **B. The marginal cost of wholesale meters has been updated and is reasonable**

2 In updating the marginal customer-related cost study at SoCalGas, the most recent meter
3 costs were used. For wholesale meters, this included several cost items, including the meter,
4 labor, contract costs, materials, regulator, and GEMS (gas energy measurement systems) device.
5 Long Beach witness Mr. Fulmer noticed that a few of these cost categories experienced large
6 increases from the last Cost Allocation Proceeding (2009 BCAP),³¹ most notably the labor,
7 contract, and materials costs. The costs used in the 2009 BCAP represented the marginal unit
8 costs at the time. The costs used in this TCAP represent the current marginal unit costs. Mr.
9 Fulmer’s proposal to use the costs from the 2009 BCAP amounts to “kicking the can down the
10 road.” If his proposal were to be adopted, in the next TCAP there could again be increases in
11 these marginal unit cost components and the same concern over them. Therefore, Long Beach’s
12 proposal should be rejected.

13 **IV. TRANSITION ADJUSTMENTS**

14 SoCalGas and SDG&E removed all existing adjustments and used a new Transition
15 Adjustment to avoid rate-shock for certain rate classes. While no parties have opposed this,
16 several have proposed some modifications.

17 **A. Proposal of Long Beach**

18 SoCalGas and SDG&E set the Transition Adjustments to yield maximum transportation
19 rate changes of approximately 10%. Also, a phase-out of the Adjustments was proposed, which
20 would last until 2019, or approximately two TCAP terms. Long Beach proposes to accelerate
21 the phasing out of transition adjustments to occur in three years, or within one TCAP period.

22 This would result in an almost 20% annual rate change for some customer classes.³² SoCalGas

³¹ A.08-02-001.

³² Testimony of Mr. Fulmer, p. 17.

1 and SDG&E believe their proposed phase-out period adequately addresses concerns over rate
2 shock while moving towards fully cost based rates, and that the six year phase-out as proposed
3 should be accepted.

4 **B. SCGC's proposal to allocate noncore Transition Adjustments**

5 SCGC claims that “the proposal to reallocate the excess revenue from the EG-D class
6 solely to the TLS rate is too restrictive.”³³ Ms. Yap proposes that the excess revenue
7 requirement being adjusted away from the EG-D customer class should be allocated to “all
8 noncore classes that would receive a rate decrease under the proposed allocation methodology.”
9 SoCalGas and SDG&E designed the transition adjustments to balance rate shock with rate
10 equity. Core rate adjustments stayed within the core classes while noncore rate adjustments
11 stayed within the noncore. Further, EG rate adjustments stayed within the TLS rate class since it
12 is largely composed of electric generation customers. The Transition Adjustments proposed by
13 SoCalGas and SDG&E should be accepted.

14 **C. DRA's transition adjustments**

15 The Transition Adjustment as proposed by SoCalGas and SDG&E would not provide the
16 same impact if the underlying allocation was different. A decision approving NCO (as
17 represented in Mr. Renaghan's testimony) would require a new adjustment. The Transition
18 Adjustment proposed by Mr. Renaghan follows the proposed adjustments made by SoCalGas
19 and SDG&E. For the reasons discussed at length above, the Commission should not adopt the
20 NCO method. In the event it does, however, SoCalGas and SDG&E do not oppose the
21 Transition Adjustment proposed by Mr. Renaghan.

³³ Direct Testimony of Ms. Yap, p. 11.

1 **V. SUMMARY OF PROPOSED TRANSPORTATION RATES**

2 Table 4 shows a comparison of the rate proposals. Columns B and C are SoCalGas' and
3 SDG&E's proposed transportation rates using the Rental Method and including transition
4 adjustments but excluding 2013's regulatory accounts. They may be found in Table 16 in the
5 September 18, 2012 Supplemental Prepared Direct Testimony of Mr. Lenart. Columns D and E
6 represent the same assumptions except using the NCO method of allocating customer-related
7 costs.

8 As can be seen, the rates are very similar. However, the residential rate decreases slightly
9 while the non-residential rates increase. This can be expected from the shifting of costs away
10 from the residential class, and onto other rate classes, that occurs under the NCO method.
11 Columns F and G³⁴ represent DRA's proposed transportation rates including DRA's proposed
12 Demand Forecast and DRA' proposed Transition Adjustment.³⁵

13

³⁴ DRA Report, DRA-03, Table 4-4 and 4-5, pages 4-6 and 4-7.

³⁵ DRA's demand forecast is discussed in the Prepared Rebuttal Testimony of Ms. Musich and Mr. Wetzel.

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**Table 4
Comparison of Transportation Rate Proposals**

	2012 Current	SoCalGas/ SDG&E Proposed Rates	% Change from 2012	Customer Costs Allocated using NCO method	% Change from 2012	NCO with DRA's Proposed Demand Forecast & Transition Adjustment	% Change from 2012	
	A	B	C	D	E	F	G	
<u>SCG:</u>								
1	Res \$/th	\$0.544	\$0.568	4%	\$0.559	3%	\$0.584	7%
2	Avg Res Bill (38 th) \$/mo	\$38.82	\$39.47	2%	\$39.15	1%	\$39.80	3%
3	CCI CA \$/th	\$0.299	\$0.243	-19%	\$0.258	-14%	\$0.285	-5%
4	Gas A/C \$/th	\$0.067	\$0.074	10%	\$0.082	23%	\$0.069	4%
5	Gas Engine \$/th	\$0.088	\$0.097	10%	\$0.019	-78%	\$0.092	4%
6	NGV Uncompressed post-SW \$/th	\$0.057	\$0.059	4%	\$0.079	40%	\$0.062	9%
7	Core Class Average \$/th	\$0.460	\$0.457	-1%	\$0.456	-1%	\$0.477	4%
8								
9	NCCI-D CA \$/th	\$0.068	\$0.053	-22%	\$0.060	-11%	\$0.060	-11%
10	EG-D Tier 1 post-SW \$/th	\$0.055	\$0.060	10%	\$0.075	38%	\$0.060	10%
11	EG-D Tier 2 post-SW \$/th	\$0.024	\$0.027	10%	\$0.031	29%	\$0.027	12%
12	TLS CA Rate csitma/efba exempt	\$0.017	\$0.012	-29%	\$0.012	-32%	\$0.012	-32%
13	TLS CA Rate csitma/efba non-exempt	\$0.018	\$0.013	-28%	\$0.012	-31%	\$0.012	-31%
14	UBS \$1,000/yr	\$27,530	\$26,476	-4%	\$26,476	-4%	\$26,476	-4%
15	BTS w/BTBA \$/dth/d	\$0.110	\$0.134	21%	\$0.134	21%	\$0.134	21%
16	SAR w/ BTS \$/th	\$0.206	\$0.199	-3%	\$0.199	-3%	\$0.201	-3%
17								
<u>SDGE:</u>								
18								
19	Res \$/th	\$0.592	\$0.649	10%	\$0.611	3%	\$0.601	1%
20	Avg Res Bill (33 th) \$/mo	\$35.697	\$36.26	2%	\$35.02	-2%	\$34.89	-2%
21	CCI CA \$/th	\$0.191	\$0.179	-7%	\$0.228	19%	\$0.213	11%
22	NGV Uncompressed post-SW \$/th	\$0.058	\$0.060	4%	\$0.081	39%	\$0.058	0%
23	Core Class Average \$/th	\$0.449	\$0.465	4%	\$0.460	2%	\$0.454	1%
24								
25	NCCI-D \$/th	\$0.122	\$0.091	-25%	\$0.125	3%	\$0.130	7%
26	EG-D Tier 1 post-SW \$/th	\$0.055	\$0.061	10%	\$0.076	38%	\$0.060	10%
27	EG-D Tier 2 post-SW \$/th	\$0.024	\$0.027	10%	\$0.031	29%	\$0.027	10%
28	TLS CA Rate csitma/efba exempt	\$0.017	\$0.012	-29%	\$0.012	-32%	\$0.012	-28%
29	TLS CA Rate csitma/efba non-exempt	\$0.019	\$0.014	-27%	\$0.013	-30%	\$0.014	-26%
30	SAR \$/th	\$0.200	\$0.203	1%	\$0.202	1%	\$0.201	1%

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Notes:

Column D is the change due exclusively to the NCO method. No changes were made to the original Transition Adjustment.
Column F are rates proposed by DRA, it is equal to Column D plus DRA's proposed demand forecast and Transition Adjustment.

6

This concludes my prepared rebuttal testimony.